No. 16-581

In the Supreme Court of the United States

LEIDOS, INC., FKA SAIC, INC.,
Petitioner,

v.

INDIANA PUBLIC RETIREMENT SYSTEM, ET AL.,
Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF OF *AMICUS CURIAE* NATIONAL ASSOCIATION OF MANUFACTURERS IN SUPPORT OF PETITIONER

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INTEREST OF *AMICUS CURIAE*[1]

The National Association of Manufacturers (the "NAM") is the largest manufacturing association in the United States, representing small and large manufacturers in every industrial sector and in all fifty states. Manufacturing employs more than twelve million men and women, contributes $2.17 trillion to the U.S. economy annually, has the largest economic impact of any major sector, and accounts for more than three-quarters of private-sector research and development in the nation. The NAM is the voice of the manufacturing community and the leading advocate for a policy agenda that helps manufacturers compete in the global economy and create jobs across the United States.

The NAM regularly participates as *amicus curiae* in cases of particular importance to the manufacturing industry. This litigation raises issues of direct concern to the members of the NAM that are public companies and to American industry as a whole. The private right of action under Section 10(b) of the Securities Exchange Act of 1934 (the "1934 Act"), 15 U.S.C. § 78j(b), and Rule 10b–5 promulgated thereunder, 17 C.F.R. § 240.10b–5, is among the most potent remedies available to investors and, as both Congress and this Court have recognized, is susceptible to abuse. The Second Circuit's decision below recognized an

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[1] All parties, including counsel for Respondents, have consented to the filing of this brief. This brief was not authored in whole or in part by counsel for any party. A party or a party's counsel did not contribute money that was intended to fund preparing or submitting this brief. No person, other than *amicus curiae*, its members, or its counsel, contributed money that was intended to fund preparing or submitting this brief.

actionable duty to disclose under Rule 10b–5 whenever an issuer is required to disclose information pursuant to a statute or regulation—in this case, the largely forward-looking Management Discussion and Analysis ("MD&A") disclosures required in every publicly traded company's quarterly and annual reports. As a result, under the Second Circuit's reasoning, a private plaintiff can state a claim under Rule 10b–5 even when omissions do not render an affirmative statement misleading. Should the Second Circuit's ruling be left intact, its expansion of the private right of action would have far-reaching implications for publicly traded companies, including the many public manufacturing companies that are members of the NAM.

SUMMARY OF ARGUMENT

In this case, the Court must decide whether to extend the private right of action for securities fraud under Section 10(b) and Rule 10b–5 to encompass certain omissions of material fact that do not render an affirmative statement misleading. In its ruling below, the Second Circuit held that a statute or regulation requiring disclosure in an issuer's public filings—here, Item 303 of Regulation S–K, 17 C.F.R. § 229.303—can give rise to a duty to disclose that is actionable under Section 10(b) and Rule 10b–5. *Indiana Pub. Ret. Sys.* v. *SAIC, Inc.*, 818 F.3d 85, 94 n.7 (2d Cir. 2016) (citing *Stratte-McClure* v. *Morgan Stanley*, 776 F.3d 94, 101 (2d Cir. 2015)). Both the Ninth Circuit and the Third Circuit have declined to recognize such a duty, and for good reason. *See In re NVIDIA Corp. Sec. Litig.*, 768 F.3d 1046, 1053–56 (9th Cir. 2014), *cert. denied*, 135 S. Ct. 2349 (2015); *Oran* v. *Stafford*, 226 F.3d 275, 287–88 (3d Cir. 2000) (Alito, J.). By permitting a private action for securities fraud to proceed in the absence of a misleading statement,

the Second Circuit strayed from the text of both Rule 10b–5 and the Private Securities Litigation Reform Act of 1995 (the "PSLRA") and expanded the private right of action far beyond what Congress intended.

The text of Rule 10b–5 could not be clearer. Rule 10b–5 makes it unlawful to "make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading." 17 C.F.R. § 240.10b–5(b). Similarly, when it codified the previously implied right of action under Rule 10b–5, Congress required private plaintiffs to plead "each statement alleged to have been misleading" and "the reason or reasons why the statement is misleading." 15 U.S.C. § 78u–4(b)(1). Consequently, "[t]o prevail on a § 10(b) claim, a plaintiff must show that the defendant made a statement that was '*misleading* as to a *material* fact.'" *Matrixx Initiatives, Inc.* v. *Siracusano*, 563 U.S. 27, 38 (2011) (quoting *Basic Inc.* v. *Levinson*, 485 U.S. 224, 238 (1988)) (emphasis in original). Nowhere do Rule 10b–5 or the PSLRA proscribe omissions beyond those that render an affirmative statement misleading. In contrast, Section 11 of the Securities Act of 1933 (the "1933 Act") provides an express right of action when an issuer's registration statement "omitted to state a material fact required to be stated therein." 15 U.S.C. § 77k(a).

By departing from the text of the applicable statutes and rules, the Second Circuit extended the Rule 10b–5 private right of action in contravention of the PSLRA and this Court's precedents. This Court long ago ceased inferring private rights of action where Congress did not intend to create them. Here, Regulation S–K, like other disclosure regulations promulgated by the

Securities and Exchange Commission (the "SEC"), does not reveal any congressional intent to allow private plaintiffs to enforce it. It is no more consistent with this Court's precedents to bootstrap these regulations onto the Rule 10b–5 private right of action than it would be to create new private rights of action under the regulations themselves. Indeed, because Congress has cabined the private right of action "to its present boundaries," *Stoneridge Inv. Partners, LLC* v. *Scientific-Atlanta*, *Inc.,* 552 U.S. 148, 165 (2008), the Second Circuit's expansion of the Rule 10b–5 private right of action undermines congressional intent rather than advancing it.

The MD&A disclosures at issue in this case provide but one example of the difficulties raised by the Second Circuit's approach. Item 303 establishes the necessary disclosures in the MD&A section of many reports required of the NAM's publicly traded members under the federal securities laws, including quarterly and annual reports. Foremost among these disclosures are any known "trends" or "uncertainties" impacting a company's liquidity, capital resources, and results of operations, 17 C.F.R. § 229.303(a), which place "particular emphasis on the registrant's prospects for the future." Management's Discussion & Analysis of Fin. Condition & Results of Operations, Exchange Act Release No. 6835, 54 Fed. Reg. 22,427, 22,428 (May 24, 1989) (hereinafter the "Interpretive Release"). Further complicating matters, the SEC has adopted a standard of materiality under Item 303 lower than that established in *Basic*. *Id.* at 22,430 n.27. With the added threat of private lawsuits for securities fraud based on pure omissions, the task of complying with Item 303––already "[t]he most significant and challenging public disclosures," 2 Thomas Lee Hazen, Treatise on the

Law of Securities Regulation § 9:50 (7th ed. 2016)—would only become more daunting.

An expansion of the private right of action is especially unnecessary in light of the other remedies available. In addition to enforcement by the SEC, private plaintiffs may prosecute express rights of action like Section 11 when applicable. Indeed, private plaintiffs may still pursue claims under Rule 10b–5 so long as they satisfy its elements—that is, they plead an omission of material fact that renders an affirmative statement misleading.

Amicus curiae respectfully submits that the Court should reverse the judgment of the Second Circuit.

ARGUMENT

I. The Second Circuit's Ruling Contravenes the Text of Rule 10b–5 and the PSLRA

In its ruling below, the Second Circuit held that a material omission in violation of Item 303 could give rise to a private action for securities fraud under Section 10(b) and Rule 10b–5. *Indiana Pub. Ret. Sys.*, 818 F.3d at 94–96. That ruling rested on an earlier opinion of the Second Circuit, *Stratte-McClure*, for which no party petitioned for certiorari.[2] *Indiana Pub. Ret. Sys.*, 818 F.3d at 94 n.7. In *Stratte-McClure*, the Second Circuit took as its starting point a footnote from this Court's decision in *Basic*, which observed that "silence, absent a duty to disclose, is not misleading under Rule 10b–5." *Stratte-McClure*, 776 F.3d at 100–01 (quoting *Basic*, 485 U.S. at 239

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[2] In *Stratte-McClure*, the Second Circuit ultimately affirmed the District Court's dismissal of the plaintiff's claims under Section 10(b) and Rule 10b–5 because the plaintiff failed to plead scienter. *Stratte-McClure*, 776 F.3d at 107–08.

n.17). Based on that reference to a "duty to disclose," the Second Circuit concluded that a material omission in violation of "Item 303's affirmative duty to disclose . . . can serve as the basis for a securities fraud claim under Section 10(b)," even if that omission does not render an affirmative statement misleading. *Stratte-McClure*, 776 F.3d at 101.

The Second Circuit erred by recognizing a new duty to disclose that is unmoored from the text of Rule 10b–5 and the PSLRA. *See Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 197 (1976) ("the starting point in every case involving construction of a statute is the language itself"). Section 10(b) makes it unlawful "[t]o use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors." 15 U.S.C. § 78j(b). Rule 10b–5—not Item 303—is the regulation that the SEC has prescribed to implement Section 10(b). *Matrixx*, 563 U.S. at 37. In relevant part, Rule 10b–5 makes it "unlawful for any person, directly or indirectly . . . [t]o make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading." 17 C.F.R. § 240.10b–5(b).

As this Court has explained, "it bears emphasis that § 10(b) and Rule 10b–5(b) do not create an affirmative duty to disclose any and all material information. Disclosure is required under these provisions only when necessary 'to make statements made, in the light of the circumstances under which they were made, not misleading.'" *Matrixx*, 563 U.S.

at 44 (quoting 17 C.F.R. § 240.10b–5(b)). As a result, "to prevail on a Rule 10b–5 claim, a plaintiff must show that the statements were *misleading* as to a *material* fact." *Basic*, 485 U.S. at 238 (emphasis in original). Critically, in *Basic* the Court reiterated this principle in the very footnote on which the Second Circuit relied: "To be actionable, of course, a statement must also be misleading." *Id.* at 239 n.17.[3]

The Court's application of Rule 10b–5 in *Matrixx* and *Basic* is further confirmed by the PSLRA, which codified the private right of action by "impos[ing]

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[3] The only other instance in which this Court has recognized an actionable duty to disclose under Rule 10b–5 is in the context of insider trading. This "disclose-or-refrain duty is extraordinary," and "it attaches only when a party has legal obligations other than a mere duty to comply with the general antifraud proscriptions in the federal securities laws." *Dirks* v. *SEC*, 463 U.S. 646, 657 (1983) (internal quotations and citation omitted). Specifically, that duty is rooted in fiduciary duties, developed under common law, that existed long before the 1934 Act. *See United States* v. *O'Hagan*, 521 U.S. 642, 652 (1997) (Under the "misappropriation" theory, "a fiduciary's undisclosed, self-serving use of a principal's information to purchase or sell securities, in breach of a duty of loyalty and confidentiality, defrauds the principal of the exclusive use of that information"); *Chiarella* v. *United States*, 445 U.S. 222, 228 (1980) (Under the "classical" theory, "the duty to disclose arises when one party has information that the other party is entitled to know because of a fiduciary or other similar relation of trust and confidence between them") (internal citation and quotations omitted). Congress intended to deter breaches of these duties, and the effect they had on the markets, when it first enacted the federal securities laws. *Dirks*, 463 U.S. at 654 n.10 ("[A] significant purpose of the Exchange Act was to eliminate the idea that use of inside information for personal advantage was a normal emolument of corporate office") (quoting *In re Cady, Roberts & Co.*, 40 S.E.C. 907, 912 n.15 (1961)).

heightened pleading requirements in actions brought pursuant to § 10(b) and Rule 10b–5." *Merrill Lynch, Pierce, Fenner & Smith Inc.* v. *Dabit*, 547 U.S. 71, 81 (2006). In such cases, "the complaint shall specify each statement alleged to have been misleading" and "the reason or reasons why the statement is misleading." *Id.* Congress crafted no exceptions to this requirement. Instead, private plaintiffs must adhere to statutory pleading standards drawn directly from the text of Rule 10b–5(b).

The Second Circuit compounded its error with its analysis of Section 11 of the 1933 Act. *See Stratte-McClure*, 776 F.3d at 100–02. Section 11 is instructive because "[t]he 1933 and 1934 Acts constitute interrelated components of the federal regulatory scheme governing transactions in securities." *Hochfelder*, 425 U.S. at 208. But, drawing from several cases from the Courts of Appeals, the Second Circuit concluded that "Item 303's affirmative duty to disclose in Form 10–Qs can serve as the basis for a securities fraud claim under Section 10(b)" because "[w]e have already held that failing to comply with Item 303 by omitting known trends or uncertainties from a registration statement or prospectus is actionable under Sections 11 and 12(a)(2)." *Id.* (citing, *inter alia*, *Panther Partners Inc.* v. *Ikanos Commc'ns, Inc.*, 681 F.3d 114, 120 (2d Cir. 2012) and *Litwin* v. *Blackstone Grp., L.P.*, 634 F.3d 706, 716 (2d Cir. 2011)).

The text of Section 11 compels the opposite conclusion. In Section 11, Congress created an express right of action against issuers and others when a registration statement "contained an untrue statement of a material fact or *omitted to state a material fact required to be stated therein* or necessary

to make the statements therein not misleading." 15 U.S.C. § 77k(a) (emphasis added). Accordingly, unlike the omissions clause of Rule 10b–5, "Section 11's omissions clause also applies when an issuer fails to make mandated disclosures—those 'required to be stated'—in a registration statement." *Omnicare, Inc.* v. *Laborers Dist. Council Const. Indus. Pension Fund*, 135 S. Ct. 1318, 1336 n.3 (2015) (quoting 15 U.S.C. § 77k(a)); *see also Herman & MacLean* v. *Huddleston*, 459 U.S. 375, 382 (1983) ("If a plaintiff purchased a security issued pursuant to a registration statement, he need only show a material misstatement or omission to establish his prima facie case"). Section 11's more expansive omissions clause illustrates that "[w]hen Congress wished to create such liability, it had little trouble doing so." *Pinter* v. *Dahl*, 486 U.S. 622, 650 (1988).[4]

To the extent the Second Circuit acknowledged the fundamental requirement that an omission render an affirmative statement misleading, it suggested a bright-line rule that every material omission in violation of Item 303 renders the remaining

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[4] The Second Circuit also invoked Section 12(a)(2) of the 1933 Act, noting that "Section 12(a)(2)'s prohibition on omissions is textually identical to that of Rule 10b–5." *Stratte-McClure*, 776 F.3d at 104 (citing 15 U.S.C. § 77l(a)(2)). By overlooking the differences between Section 11 and Section 12(a)(2), the Second Circuit made the same mistake as it did in equating the omissions clauses of Section 11 and Rule 10b–5. Indeed, the Second Circuit had already recognized these differences: "Whereas section 11 contemplates actions based on 'omissions of material fact required to be stated' in registration statements, section 12(a)(2) lacks parallel language regarding prospectuses and oral communications." *In re Morgan Stanley Info. Fund Sec. Litig.*, 592 F.3d 347, 361 n.8 (2d Cir. 2010).

disclosures made under Item 303 misleading: "Due to the obligatory nature of these regulations, a reasonable investor would interpret the absence of an Item 303 disclosure to imply the nonexistence of 'known trends or uncertainties that the registrant reasonably expects will have a material unfavorable impact on revenues or income from continuing operations.'" *Stratte-McClure*, 776 F.3d at 102 (quoting 17 C.F.R. § 229.303(a)(3)(ii)).

That end-run around the text of Rule 10b–5 violates another teaching of *Matrixx* and *Basic*. This Court has repeatedly refused to "reduce[]" the test for identifying a material misstatement or omission "to a bright-line rule." *Matrixx*, 563 U.S. at 30. As the Court explained in *Basic*, "[a] bright-line rule indeed is easier to follow," but it must "necessarily be overinclusive or underinclusive." *Basic*, 485 U.S. at 236. As the Court predicted, the Second Circuit's suggestion is indeed overinclusive because it embraces omissions beyond those that Rule 10b–5 proscribes.

II. The Second Circuit's Ruling Expands the Private Right of Action Under Rule 10b–5

The consequences of the Second Circuit's ruling are as extensive as they are harmful. By transforming a pure omission in violation of Item 303—or any other statute or regulation requiring disclosure—into an actionable omission under Rule 10b–5, the Second Circuit has done indirectly what it cannot do directly. In doing so, it has dramatically expanded the private right of action under Rule 10b–5.

This Court is no longer in the business of creating private rights of action in the absence of congressional intent "no matter how desirable that might be as a

policy matter, or how compatible with the statute." *Alexander* v. *Sandoval*, 532 U.S. 275, 286–87 (2001). Instead, "private rights of action to enforce federal law must be created by Congress." *Id.* at 286. It is therefore not the case that "every provision of the securities Acts gives rise to an implied private cause of action." *Touche Ross & Co.* v. *Redington*, 442 U.S. 560, 577 (1979). For instance, in *Touche Ross & Company*, the Court declined to infer a private right of action under Section 17(a) of the 1934 Act when that provision "simply requires broker-dealers and others to keep such records and file such reports as the Commission may prescribe." *Id.* at 569. As the Court observed, unlike Section 10(b), "Section 17(a) neither confers rights on private parties nor proscribes any conduct as unlawful." *Id. See also Transamerica Mortg. Advisors, Inc. (TAMA)* v. *Lewis*, 444 U.S. 11, 19–24 (1979) (declining to infer a private right of action under Section 206 of the Investment Advisers Act of 1940); *Alexander*, 532 U.S. at 287 (noting that the Court has "abandoned" its willingness to infer private rights of action absent congressional intent "even when interpreting the [] Securities Exchange Act of 1934") (collecting cases).

Similarly, none of the statutes or regulations establishing the disclosure requirements for the NAM's publicly traded members includes a private right of action or suggests that Congress intended that they be privately enforced. Section 13 of the 1934 Act simply requires issuers to comply with reporting requirements "in accordance with such rules and regulations as the Commission may prescribe." 15 U.S.C. § 78m(a). The SEC has since prescribed regulations setting forth hundreds of line items that must be contained in registration statements,

quarterly and annual reports, proxy statements, and other documents required under the 1933 and 1934 Acts. Item 303 itself forms one subpart of Regulation S–K, which "states the requirements applicable to the content of the non-financial statement portions of" documents that issuers must file. 17 C.F.R. § 229.10(a). Regulation S–K contains 12 additional subparts and, in total, lists 105 separately captioned disclosure items. *See* 17 C.F.R. § 229.10 *et seq*. In turn, most of these 105 items have numerous subsections. Regulation S–K was "adopted pursuant to sections 12, 13, 14, 15(d) and 23(a) of the Exchange Act," Adoption of Disclosure Regulation and Amendments of Disclosure Forms and Rules, Securities Act Release No. 5983, 42 Fed. Reg. 65,554, 65,566 (Dec. 23, 1977), while Item 303 was adopted later "pursuant to the authority in sections 6, 7, 8, 10 and 19(a) of the Securities Act of 1933." Adoption of Integrated Disclosure System, Securities Act Release No. 6383, 47 Fed. Reg. 11,380, 11,400 (Mar. 16, 1982).

As a result, neither this Court nor any of the Courts of Appeals have recognized a private right of action under Item 303. As the Third Circuit observed, "[n]either the language of the regulation nor the SEC's interpretative releases construing [Item 303] suggest that it was intended to establish a private cause of action, and courts construing the provision have unanimously held that it does not do so." *Oran*, 226 F.3d at 287; *see also In re Sofamor Danek Group, Inc.,* 123 F.3d 394, 403 (6th Cir. 1997) ("[C]ourts have been reluctant to recognize a private right of action under Item 303").

The Second Circuit's ruling attempts to sidestep this precedent by bootstrapping a nonexistent private right of action under Item 303 onto the existing

private right of action under Rule 10b–5. But the same principles that preclude private rights of action under the disclosure regulations themselves counsel against grafting those same regulations onto Rule 10b–5. *See Stoneridge*, 552 U.S. at 165 ("Concerns with the judicial creation of a private cause of action caution against its expansion."). Although this Court once acquiesced to an implied private right of action under Section 10(b) and Rule 10b–5, *see Superintendent of Ins. of State of N. Y.* v. *Bankers Life & Cas. Co.*, 404 U.S. 6, 13 n.9 (1971), it also acknowledged that the implied right of action was "a judicial oak which has grown from little more than a legislative acorn." *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 737 (1975). The Court further recognized that "litigation under Rule 10b–5 presents a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general." *Id.* at 739.

In 1995, Congress reached a similar conclusion. Through the PSLRA, Congress sought to curb "perceived abuses of the class-action vehicle in litigation involving nationally traded securities," including "nuisance filings, targeting of deep-pocket defendants, vexatious discovery requests, and 'manipulation by class action lawyers of the clients whom they purportedly represent.'" *Dabit*, 547 U.S. at 81 (quoting H.R. Conf. Rep. No. 104–369, at 31–32 (1995)). As a result, the congressional intent that the Court once had to divine, *see Blue Chip Stamps*, 421 U.S. at 748–49, is now reflected in the PSLRA.

The intent of Congress remains clear. "[W]hen § 78u–4 was enacted, Congress accepted the § 10(b) private cause of action as then defined but chose to extend it no further." *Stoneridge*, 552 U.S. at 165. As

a result, this Court has adhered to the will of Congress and struck a careful balance as to who can be sued under Rule 10b–5's private right of action and for what conduct. *See, e.g., Janus Capital Grp., Inc.* v. *First Derivative Traders*, 564 U.S. 135, 142 (2011) (limiting the private right of action to persons or entities making a statement); *Stoneridge*, 552 U.S. at 152–53 (holding that the private right of action does not reach secondary actors absent reliance on those actors' statements); *Tellabs, Inc.* v. *Makor Issues & Rights, Ltd.*, 551 U.S. 308, 314 (2007) (describing the allegations necessary to plead scienter); *see also Central Bank of Denver, N.A.* v. *First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 191 (1994) (precluding aiding and abetting liability under the private right of action). These cases embody the guiding principle that "the § 10(b) private right should not be extended beyond its present boundaries." *Id.* (citing *Virginia Bankshares, Inc.* v. *Sandberg*, 501 U.S. 1083, 1102 (1991); *Central Bank*, 511 U.S. at 173).

The Second Circuit's ruling crossed well beyond those boundaries. Far from limiting its holding to Item 303, the Second Circuit opined that "a duty to disclose under Section 10(b) can derive from *statutes or regulations* that obligate a party to speak." *Stratte-McClure*, 776 F.3d at 102 (emphasis added). If the Court adopts the Second Circuit's reasoning, private actions under Rule 10b–5 will inevitably encompass the entire host of regulations defining the disclosure requirements for public companies.

The results so far bear out this prediction. Since *Stratte-McClure* was decided, some two dozen private actions have been filed within the Second Circuit alleging violations of Rule 10b–5 based on omissions of information required to be disclosed under Item

303. *See, e.g., Lopez* v. *Ctpartners Exec. Search Inc.*, 173 F. Supp. 3d 12 (S.D.N.Y. 2016); *In re Lions Gate Entm't Corp. Sec. Litig.*, 165 F. Supp. 3d 1 (S.D.N.Y. 2016). And just as predictably, other private actions relying on *Stratte-McClure* have been filed both outside the Second Circuit, *see, e.g., Izadjoo* v. *Helix Energy Sols. Grp., Inc.*, --- F. Supp. 3d ---, No. CV H-15-2213, 2017 WL 590383 (S.D. Tex. Feb. 14, 2017), *Beaver Cty. Employees' Ret. Fund* v. *Tile Shop Holdings, Inc.*, 94 F. Supp. 3d 1035, 1047 (D. Minn. 2015), and within the Second Circuit but invoking other disclosure requirements, *see, e.g., Christine Asia Co.* v. *Alibaba Grp. Holding Ltd.*, 192 F. Supp. 3d 456 (S.D.N.Y. 2016) (Item 503 of Regulation S–K and Item 5(d) of Form 20–F); *Dingee* v. *Wayfair Inc.*, No. 15CV6941(DLC), 2016 WL 3017401 (S.D.N.Y. May 24, 2016) (Item 503 of Regulation S–K).

The Second Circuit's holding therefore threatens to open the floodgates of vexatious Rule 10b–5 litigation against the NAM's publicly traded members and other publicly traded companies. Such an outcome will only undermine Congress's intent to reduce abusive private actions for securities fraud. *See Dabit*, 547 U.S. at 81–82.

III. The Complexities of Item 303 Illustrate the Dangers Presented by Allowing Private Enforcement of Disclosure Regulations

The problems inherent in making pure omissions under Item 303 privately actionable under Rule 10b–5 provide but a glimpse into the problems that the NAM's publicly traded members will confront if the Second Circuit's judgment is allowed to stand. For all of the complications that the forward-looking disclosures required under Item 303 present,

different problems can be expected to arise under the hundreds of other disclosure requirements that the SEC has promulgated.

The MD&A requirements of Item 303 "are intended to provide, in one section of a filing, material historical and prospective textual disclosure enabling investors and other users to assess the financial condition and results of operations of the registrant, *with particular emphasis on the registrant's prospects for the future*." Interpretative Release, 54 Fed. Reg. at 22,428 (emphasis added). The SEC's emphasis on the future has led at least one commentator to conclude that "[t]he most significant and challenging public disclosures are those required by item 303 of Regulation S–K . . . ." Hazen, *supra*, § 9:50. Among other information, Item 303 requires quarterly disclosure of:

- "any known trends or any known demands, commitments, events or uncertainties that will result in or that are reasonably likely to result in the registrant's liquidity increasing or decreasing in any material way," 17 C.F.R. § 229.303(a)(1);
- "any known material trends, favorable or unfavorable, in the registrant's capital resources," 17 C.F.R. § 229.303(a)(2)(ii); and
- "any known trends or uncertainties that have had or that the registrant reasonably expects will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations." 17 C.F.R. § 229.303(a)(3)(ii).

The SEC has observed that these provisions "require disclosure of forward-looking information" that "may involve some prediction or projection." Interpretive Release, 54 Fed. Reg. at 22,429. To comply with Item 303, the SEC has advised issuers to draw the "critical distinction" between "currently known trends, events, and uncertainties that are *reasonably expected* to have material effects," and those trends, events, and uncertainties that are merely "*anticipated*" or whose impact is "*less predictable*." *Id.* (quoting in part Concept Release on Management's Discussion & Analysis of Financial Condition & Operations, Securities Act Release No. 6711, 52 Fed. Reg. 13715, 13717 (Apr. 17, 1987)) (emphasis altered). A subsequent SEC statement opined that this "reasonably likely" threshold "is lower than 'more likely than not.'" Comm'n Statement About Management's Discussion & Analysis of Fin. Condition & Results of Operations, Securities Act Release No. 8056, 67 Fed. Reg. 3746, 3748 (Jan. 25, 2002). Not surprisingly, therefore, "[t]he line between those MD&A disclosures which are required and those which may be avoided is far from a clear one." Hazen, *supra*, § 9:50.

The different—and lower—standard for materiality under Item 303 only exacerbates the difficulty for issuers attempting to craft the required disclosures. *See id.* at 22,430 n.27. In adopting Item 303, the SEC has "specifie[d] its own standard for disclosure—i.e., reasonably likely to have a material effect"—and disavowed the materiality test established in *Basic*. *Id.* ("The probability/magnitude test for materiality approved by the Supreme Court in [*Basic*] is

inapposite to Item 303 disclosure.").[5] As a result, Item 303's "disclosure obligations extend considerably beyond those required by Rule 10b–5." *Oran*, 226 F.3d at 288.

Given these differences, if the Second Circuit's ruling is affirmed, it will introduce still more uncertainty into an area "that demands certainty and predictability." *See Pinter*, 486 U.S. at 652. The logical recourse for the NAM's publicly traded members is to overdisclose potential "trends and uncertainties" so that they might mitigate the increased likelihood of being sued for securities fraud. As the Court first anticipated over forty years ago, such a rule of law will "lead management simply to bury the shareholders in an avalanche of trivial information—a result that is hardly conducive to informed decisionmaking." *Basic*, 485 U.S. at 230–31 (quoting *TSC Industries, Inc.* v. *Northway, Inc.*, 426 U.S. 438,

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[5] The SEC's test for materiality under Item 303 is as follows:

> Where a trend, demand, commitment, event or uncertainty is known, management must make two assessments:
>
> (1) Is the known trend, demand, commitment, event or uncertainty likely to come to fruition? If management determines that it is not reasonably likely to occur, no disclosure is required.
>
> (2) If management cannot make that determination, it must evaluate objectively the consequences of the known trend, demand, commitment, event or uncertainty, on the assumption that it will come to fruition. Disclosure is then required unless management determines that a material effect on the registrant's financial condition or results of operations is not reasonably likely to occur.
>
> Interpretive Release, 54 Fed. Reg. at 22,430.

448–49 (1976)). That outcome can only frustrate the SEC's stated policy of "enabling investors and other users to assess . . . the registrant's prospects for the future." Interpretive Release, 54 Fed. Reg. at 22,428.

IV. Expansion of the Private Right of Action Under Rule 10b–5 Is Unnecessary

An expansion of the private right of action under Rule 10b–5 is also unnecessary in light of the other remedies that are available. As this Court has cautioned, efforts to "make[] the civil remedy more far reaching" do not necessarily mean that "the objectives of the statute are better served." *Cent. Bank of Denver*, 511 U.S. at 188.

"The SEC vigorously enforces the MD&A disclosure requirements." Hazen, *supra*, § 9:50. Indeed, because the SEC can and does bring enforcement actions for violations of Item 303 pursuant to Section 13 of the Exchange Act, 15 U.S.C. § 78m, it need not prove fraud under Rule 10b–5 or the other antifraud provisions. *See, e.g., In the Matter of Eric W. Kirchner & Richard G. Rodick*, Exchange Act Release No. 3877 (June 15, 2017) (settling claims against issuer's chief executive officer and chief financial officer under Section 13(a) of the 1934 Act and Rules 12b–20 and 13a–13); *In the Matter of Bank of Am. Corp.*, Exchange Act Release No. 72888 (Aug. 21, 2014) (settling claims against issuer under Section 13(a) of the 1934 Act and Rules 12b–20 and 13a–13); *In the Matter of Caterpillar Inc.*, 50 S.E.C. 903 (Mar. 31, 1992) (settling claims against issuer under Section 13(a) of the 1934 Act and Rules 13a–1 and 13a–13). These actions confirm that "[t]he enforcement power is not toothless." *Stoneridge*, 552 U.S. at 166.

Private plaintiffs have remedies as well. As the Ninth Circuit has explained, "[t]here is liability under section 11 if a registrant 'omits to state a material fact required to be stated' in the registration statement. Therefore, any omission of facts 'required to be stated' under Item 303 will produce liability under Section 11." *Steckman* v. *Hart Brewing, Inc.*, 143 F.3d 1293, 1296 (9th Cir. 1998) (quoting 15 U.S.C. § 77k(a)); *see also Panther Partners*, 681 F.3d at 120; *Litwin*, 634 F.3d at 716.

Perhaps the most important remedy is the existing private right of action under Rule 10b–5. MD&A disclosures, like any other statement made to the market, are actionable under Rule 10b–5 *if* "a duty to disclose" is "separately shown." *Oran*, 226 F.3d at 288. That requires a plaintiff to "show that the defendant made a statement that was '*misleading* as to a *material* fact.'" *Matrixx*, 563 U.S. at 38. Indeed, as the Second Circuit recognized, this Court has articulated a specific standard by which "the materiality of an allegedly required forward-looking disclosure is determined" under Rule 10b–5. *Stratte-McClure*, 776 F.3d at 102–03 (citing *Basic*, 485 U.S. at 238). Such forward-looking disclosures remain actionable under Rule 10b–5 so long as all of the elements are satisfied and the PSLRA's statutory safe harbor does not apply. *See* 15 U.S.C. § 78u–5.

CONCLUSION

For the reasons set forth above, the judgment of the Second Circuit should be reversed.

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